

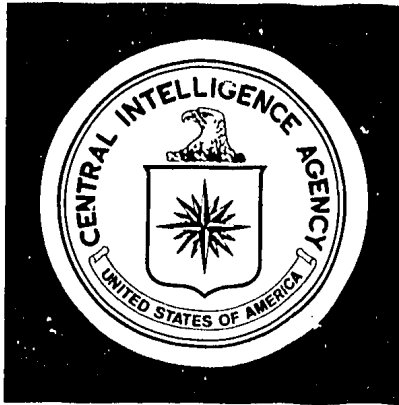
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Foreign Reaction to the US Proposal for Monetary Reform

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1972

INTELLIGENCE MEMORANDUM

**FOREIGN REACTION TO THE US
PROPOSAL FOR MONETARY REFORM**

Introduction

1. In a 26 September address to the annual meeting of the World Bank and the International Monetary Fund (IMF), Secretary of the Treasury George P. Shultz outlined a US plan for reforming the international monetary system. This memorandum summarizes and evaluates the initial foreign official and press reaction to the US proposal, based on reports through 3 October 1972.

Summary

2. Foreign reaction to the US proposal for international monetary reform has generally been favorable. The plan was seen as an unexpected indication that Washington is now ready to begin meaningful negotiations. Those commenting felt that the announcement's timing would give impetus to the newly formed Committee of Twenty, the principal forum for the monetary reform discussions.

3. Although opposed to many specific US proposals, foreign officials and the press generally saw both a new conciliatory tone in the Secretary's speech and an indication of a more flexible US approach to monetary and trade problems. Critics of US international monetary policy, including the French, have been somewhat muted.

4. The apparent US willingness to see the dollar's role as a reserve currency reduced has been well received. Foreign observers are also pleased that Washington publicly considered restoring dollar convertibility even though conditions and timing remain vague. There is a new consensus that

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any reform proposal must include an enhanced role for Special Drawing Rights (SDRs), but significant differences still remain over detail. US acceptance of this notion is being widely applauded. Some foreign officials and press also welcome what appears to them to be a loosening of the link between trade policy and dollar convertibility, while others feel that US trade demands, although not advanced in the harsh tone previously used, are still far-reaching.

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6. Official foreign and press reports have almost universally rejected two principal elements of the US proposal - namely that countries with persistent balance-of-payments surpluses or deficits be required to take corrective action or face international economic sanctions and that objective criteria be used to determine when such action is needed. Countries with large or growing foreign exchange reserve positions, particularly Japan and West Germany (see the table), deny that changes in official reserves are appropriate criteria for judging when a country is in balance-of-payments disequilibrium. The Japanese and West German viewpoint has been seconded by officials from other countries with strong reserve positions, such as France, Canada, and Australia.

Reserve Position of the Group of Ten
August 1972

	Million US \$		
	Reserves		Changes in
	Total	Foreign Exchange	Reserves from 31 December 1971
United States	13,123	234	-838
Belgium	4,070	1,258	528
Canada	6,199	4,536	381
France	9,961	4,994	1,549
Italy	6,687	2,840	-206
Japan	16,372	14,557	885
Netherlands	4,910	1,513	1,040
Sweden	1,401	974	257
United Kingdom	6,091	4,516	-3,041
West Germany	24,581	18,001	6,019

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7. Detailed evaluation of the US reform proposal and the development of counter-proposals is only now beginning. The consensus is that agreement on monetary reform will take from 18 to 36 months. Foreign officials have consequently avoided making specific technical comments on the US proposal, preferring instead to study the proposal in greater detail. European comment has also been tempered by the desire to develop a coordinated European Community (EC) response to the US initiative.

Discussion

European and Canadian Reactions

West Germany

8. Official West German reaction to the Secretary's speech, while generally favorable, is cautiously reserved. Bonn welcomed Washington's willingness to restore dollar convertibility, see the dollar's reserve currency role diminished, and make SDRs the prime reserve medium. These officials also agree that the new monetary system should be based on fixed, but more flexible, exchange rates.

9. Bonn is lukewarm, however, to the concept of surplus-country responsibility for restoring external equilibrium. It is wary of any proposal for objective criteria to determine whether a country is faced with persistent balance-of-payments disequilibrium and for international sanctions against countries that fail to take corrective action. Aware that West Germany's official reserves are by far the world's largest, Minister of Economics and Finance Helmut Schmidt pointed to the deteriorating current account balance and emphasized that changes in official reserves are not appropriate criteria for judging whether a currency is in disequilibrium.

10. Schmidt felt that the Secretary's proposal was not directed at Bonn and that West Germany will not have to revalue again in the near future. Bundesbank President Klasen also objected to automatic parity adjustments. He did not, however, foreclose the possibility of a future Deutschemark float.

11. Comment in the quality press was generally favorable. *Der Spiegel* called Secretary Shultz's address the smash hit of the meeting. *Frankfurter Allgemeine Zeitung* observed that the US proposal was viewed in Germany as representing significant progress. It quoted the Bundesbank's Vice President Emminger as saying that the Group of Twenty, charged with

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reform work, now has a usable working paper in addition to the reform catalog provided by the IMF's executive directors. The Hamburg *Die Welt* said the speech enhanced the optimism among monetary strategists that a basic concept for a new currency system could be mapped out in the foreseeable future.

12. Many papers were critical, however, of several points in the US plan. The *Handelsblatt* stated that, for surpluses arising largely from speculative inflows (as in the case of West Germany), the proposed objective criteria would be quite untenable. The paper also considers the proposal to remove all current restrictions on the creation of SDRs as highly controversial. The pro-Christian Democratic *Muenchner Merkur* criticized Washington for expecting its allies to voluntarily restrict exports to the United States, lower customs barriers for American goods, and further revalue their currencies to improve the US balance of payments. *Koelner Stadtanzeiger* referred to experts who believed the US proposals should not evoke any euphoria. These experts point out, the paper stated, that the plan contains nothing new; all its ideas have been expressed lately by other US officials.

13. According to foreign exchange dealers in Frankfurt, the proposal was well received by the market. The Secretary's pledge to make the dollar convertible into other reserve assets was singled out as the one positive concrete feature in the US plan. However, the top executive of the Westdeutsche Landesbank Girozentrale, Ludwig Poullain, struck a more pessimistic note. He feels it is an illusion to think that a new Bretton Woods is possible. He urged Bonn to stop giving in to the French and embark on an active monetary policy course harmonized with the requirements of economic stability and based on periodic revaluations of a freely floating Deutschemark.

France

14. After some initial critical comment, French reaction has been cautiously positive. Paris appears generally pleased with the US position and sees the outlook for monetary reform as much improved. French officials have stressed the conciliatory nature of the proposal, noting a changed tone in the US approach toward resolving international monetary and trade problems and an apparent willingness to negotiate on outstanding issues. Paris appears to agree with US suggestions that more flexible parities are desirable and that SDRs should be the prime source of new liquidity. The French also welcomed US willingness to restore dollar convertibility.

15. The French are opposed, however, to any automatic rule for determining that a parity change is required. They also believe that foreign

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holdings of national currencies (for example, dollars) exceeding needed working balances should be banned.

16. The French press has also stressed the conciliatory nature of Secretary Shultz's proposal. In a detailed account of immediate reactions to the speech, AFP's Washington correspondent Michel Camus on the 27th of September summarized the views of observers at the conference who stressed the conciliatory tone of the speech. He added that the US propositions were set forth in a clear and coherent manner and were demanding but reasonable. Turning to a substantive analysis of the US proposal, Camus noted that for the first time the United States is considering restoring dollar convertibility even if the time and conditions were purposely kept vague. Camus also stressed the US admission that gold would play a monetary role for an undetermined period.

17. Much of the French press saw the beginning of a French-US rapprochement, with Paris making greater concessions than Washington. There was considerable speculation that Paris had softened its stand as a result of the Pompidou-Kissinger talks. The French Communist Party's *L'Humanite* attacked Minister of Finance and Economic Affairs Giscard d'Estaing for siding with the United States. Citing *Le Monde* to the effect that the French minister's speech to the IMF and World Bank conference was redrafted at the last minute on the instructions of the Elysee Palace, *L'Humanite* alleged that new instructions were sent to the French delegation at the conference following the Kissinger visit.

United Kingdom, Other Europe, and Canada

18. Initial British reaction has been low-keyed. UK officials previously supported the US view that both surplus and deficit countries have equal rights and obligations and that exchange rates should be more flexible. The British delegation at the IMF meeting, however, emphasized that the decision to eliminate a payments imbalance should be left to national authorities.

19. The London press, in generally favorable comment, remarked on the conciliatory tone of the speech, notwithstanding its hard line with respect to countries in constant reserve surplus. The *Financial Times* said dollar convertibility appeared to have been offered in exchange for a monetary system which would help all countries to keep their external payments in equilibrium. The *Daily Telegraph* questioned the administration's sincerity in agreeing to monetary reform not tied to trade reform, a position contrary to all that US spokesmen have said this year. The paper commented that Washington may be looking much farther ahead than next year, to the time when it may become locked in a kind of semipermanent deficit position.

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20. Belgian reaction has on the whole been positive. The press hailed the United States for finally setting forth principles on which monetary negotiations could be based. The influential Catholic *De Standaard*, although referring to the plan as the first concrete US proposal since the 1971 decision on monetary reform, condemned the US monetary strategy as clearly nationalistic and accused Washington of being less interested in reform than in trade concessions.

21. Because of Dutch preoccupation with the election campaign and domestic economic problems, there has been little reaction to Secretary Shultz's proposal. News reports emphasized that the speech contained welcome evidence of US willingness to move forward. Reports also focused heavily on the US intention to convert foreign dollar holdings after a transitional period, lauding it as a positive step but one which would probably not be realized for a long time.

22. Canadian official and press reaction has generally been favorable. Ottawa agrees that the dollar's international role should be reduced, the role of SDRs enhanced, and the dollar band widened. Canadian officials have not commented on the proposal to impose international economic sanctions against countries that fail to take action to reduce persistent payments surpluses or deficits. They have expressed disagreement, however, with the proposal that objective criteria be established to determine when action is needed. Minister of Finance Turner indicated a preference for give-and-take multilateral negotiations rather than a mechanistic approach. The Canadian press had little quarrel with the basic US proposal but expressed concern that the parts of the plan dealing with currency floats were aimed directly at Canada.

Japanese and Pacific Reactions

Japan

23. Japanese officials had hoped for an uneventful IMF meeting and were obviously surprised by the strong US proposal. They were particularly disturbed by the suggestion that a surcharge be placed on imports from countries with chronic trade surpluses, believing that this may foreshadow a US move against Japanese exports. A recurrent theme in official comment was that the US unfairly sought to shift the onus for international monetary problems to surplus countries such as Japan.

24. Tokyo was also disturbed by the general absence of a negative reaction to the US proposal in Western Europe, feeling that this left Japan in a relatively isolated position. The two senior Japanese officials at the IMF meeting, Minister of Finance Ueki and Bank of Japan Governor Sasaki,

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publicly attempted to downplay the notion that the US proposal was aimed solely at Japan, but these statements were mainly intended to calm growing pressures for another yen revaluation. During and immediately following the IMF meetings the Bank of Japan had to buy large amounts of dollars to prevent the yen from breaching the Smithsonian band.

25. The Japanese press gave front page coverage to the US proposals, with lead articles displacing even the Tanaka-Chou talks for a day. A consistent theme of early reporting was that the United States might be setting the stage for a unilateral imposition of a surcharge on imports from Japan. Early coverage also stressed that the US proposal advocating that countries with balance-of-payments deficits move against those with surpluses would tread on nations' sovereign rights. They stated that the government had been surprised at the speed at which the United States and Western Europe seemed willing to move in reforming the international monetary system, and it raised the specter of another yen revaluation. Later coverage was less strident and Tokyo was urged to take resolute action to reduce Japan's huge trade surplus and defuse foreign pressure.

Australia

26. The Australian press has given the Secretary's speech wide coverage. Much has been factual, based on wire service reports from Washington reporting the initial favorable reaction from delegates to the IMF conference and describing the US proposal as demanding but reasonable. Editorial and feature writers reacted negatively, however, mainly for domestic political reasons. Since late 1971, Australia's foreign exchange reserves have tripled reaching over \$5 billion, and there has been increasing discussion of a revaluation. The US proposals, by suggesting revaluation for countries with large reserves, are opening an issue that the ruling coalition would rather avoid. Within the coalition the Country Party, representing Australia's rural interests, adamantly opposes any revaluation because it would reduce profits on agricultural exports.

Latin American Reactions

27. Latin America's reaction has been one of wary optimism. The Secretary's promise that the United States would not hide its problems behind the walls of protectionism was received with caution. His statements regarding the future role of SDRs were construed as a hopeful sign that the excess liquidity of some countries would be converted into a new element for aid to less developed countries (LDCs). In general, Latin America viewed the US proposal as a good basis for the lengthy negotiations yet to come.

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28. Brazil's comments on the Secretary's reform proposals thus far have been highly laudatory. Although Brazil has by far the largest and fastest growing foreign reserves in Latin America, it does not expect to be hurt by proposed pressures on surplus countries to revalue their currencies. Spokesmen have been quick to point out that Brazil's balance-of-payments surplus stems from favorable foreign investment policies and masks a rapidly expanding deficit on current account. Professor Otavio Gouveia de Bulhoes, one of the early architects of the military government's economic policies and a delegate to the Bretton Woods Conference, has publicly lauded the speech as a major step toward solving the world monetary crisis, pointing in particular to proposals regarding revaluation by surplus countries as a significant advance over ideas prevailing at the 1944 monetary conference. Minister of Finance Delfim Neto also has taken a positive -- albeit more cautious -- view of the impact of the US proposal on Brazil and other developing economies.

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